

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

June 20, 2006

The Capital Projects and Bond Oversight Committee met on Tuesday, June 20, 2006, at 1:00 PM, in Room 129 of the Capitol Annex. Representative Mike Denham, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Elizabeth Tori, Co-Chair; Representative Mike Denham, Co-Chair; Senators Tom Buford and Dan Seum; and Representative Paul Marcotte.

Guests testifying before the Committee: Lance Broeking, University of Kentucky; Jim Abbott and Nancy Brownlee, Finance and Administration Cabinet; John Hicks, Governor's Office for Policy and Management; Sandy Williams, Kentucky Infrastructure Authority; and Terri Fugate, Office of Financial Management.

LRC Staff: Nancy Osborne, Pat Ingram, Bart Hardin, Kristi Culpepper, and Shawn Bowen.

Representative Denham introduced Leah Hinson, who is serving as an LRC summer intern. He also recognized John Farris, the newly appointed secretary of the Finance and Administration Cabinet.

Secretary Farris thanked the Committee for inviting him to the meeting, and said he looked forward to continuing the good working relationship between the Committee and the Finance and Administration Cabinet.

Senator Buford made a motion to approve the minutes of the May 18, 2006 meeting. The motion was seconded by Senator Tori and approved by voice vote.

Representative Denham called on Ms. Nancy Osborne, Committee Staff, to review correspondence and information items included in members' folders. Ms. Osborne said the folders included three items of correspondence: correspondence from Jim Abbott, Commissioner, Department for Facilities and Support Services, updating the Committee on the proposed exchange of property and hotel development at the site of the Bert T. Combs Building in Bell County; correspondence submitted by the University of Kentucky regarding the purchase of unbudgeted medical equipment; and the Kentucky Lottery Corporation's monthly financial report for April 2006.

Ms. Osborne said five information items were also included in members' folders: a staff update on various capital projects; court facility project status reports from the Administrative Office of the Courts; a report submitted by the Kentucky Infrastructure Authority: *General Programmatic Overview by First Southwest Company*; and the updated monthly and weekly debt issuance calendar.

Ms. Osborne briefly discussed two items contained in the monthly staff update. She noted Kentucky is scheduled to be the first state to launch a satellite. The launch is planned for 2007, and the project is sponsored by a coalition of state universities and agencies. Also, she noted that a design flaw was discovered in the Frankfort Airport Runway Extension project. The design firm, HMB, and its insurer are working with the Finance and Administration Cabinet to rectify this problem.

Representative Denham asked how this project came to have a design flaw. Mr. Jim Abbott, Commissioner for Facilities and Support Services, Finance and Administration Cabinet, said the airport runway is not in compliance with Federal Aviation Administration (FAA) regulations. He explained that aircraft need at least 4,000 feet of runway, but only 3,300 feet will be available when the airport reopens. The runway physically has a hump in the middle that prohibits the correct line of sight. The flaw was discovered by the design firm during the later part of May, and they have been working to develop and implement a corrected design. Mr. Abbott said it will cost approximately \$800,000 to make this correction, and HMB will underwrite the cost. He noted the project is currently under budget by \$5,000.

In response to another question from Representative Denham, Mr. Abbott said they do not have a timeframe as to how long it will take to correct the error. The original contract was scheduled for completion at the end of June, but that has now been delayed. Mr. Abbott said they hope to learn the exact cost and timeframe after meeting with the contractor, Hinkle Construction, this week.

Representative Marcotte asked if the project will have the required 4,000 ft. of runway once it is completed. Mr. Abbott responded affirmatively, and said the only difference will be the safety overrun at the end of the runway will be at a different contour than the original design.

Representative Denham introduced Mr. Lance Broeking, University of Kentucky (UK) Campus Services Administrator, to discuss two University leases. Mr. Broeking first reported the renewal of a lease for the UK Kentucky Injury Prevention and Research Center and the College of Dentistry. The lease is being renewed at an annual cost of \$116,994. Mr. Broeking said the space requirements for this lease were reduced from 10,281 SF to 9,176 SF, due to the expiration of a federal grant. The lease is being renewed at the same cost per square foot. No further action was required on this lease since the rate will not change.

Mr. Broeking next reported the renewal of a lease for the UK Department of Anthropology. The lease is being renewed at an annual cost of \$113,400, a 33% increase in cost. Mr. Broeking said the University was required to advertise for space since the lessor requested an increase. However, only one response other than one from the current lessor was received, and it did not meet the University's space requirements.

Senator Buford made a motion to approve the lease renewal report for the UK Department of Anthropology. The motion was by seconded by Representative Marcotte and approved by unanimous roll call vote.

Representative Denham asked Mr. John Hicks, Deputy State Budget Director, Governor's Office for Policy and Management, and Mr. Abbott to present the Finance Cabinet's monthly report to the Committee. Mr. Hicks reported an emergency project for the Kentucky Community and Technical College System (KCTCS) at Madisonville Community College. Mr. Hicks said this project will cost \$532,500 and will involve the replacement of chiller and cooling towers that serve the Gray Building, the Learning Resource Center, and the Fine Arts Center. The project will be funded from KCTCS restricted funds. Emergency projects must be reported to the Committee within 30 days. No further Committee action was required.

Mr. Hicks next reported that the Finance and Administration Cabinet has approved paying \$1,358,300 from the General Fund Surplus Account for expenses associated with relocating four state offices from the Capitol Annex to various other locations. The Department of Agriculture, the Division of Engineering and Contract Administration, and the Executive Branch Ethics Commission moved to other state-owned space, and the Department of the Treasury moved to leased space. Nine Finance Cabinet offices were then relocated to areas vacated within the Capitol Annex to provide the space to the Legislative Branch.

Mr. Hicks said HB 267, the 2004-06 budget bill, authorized that moving costs associated with the executive branch vacating the space were to be deemed necessary governmental expenses and paid from the General Fund Surplus Account.

Senator Buford asked if this dollar amount being reported today represents all the moving costs that will be incurred. Mr. Hicks said the figure being reported today is considered to be the year end total.

Representative Denham said this project did not require any Committee action.

Lastly, Mr. Hicks reported that the Finance Cabinet has approved initiation of a project to install a new HVAC system at the Louisville National Guard Armory at a cost of \$485,074. Mr. Hicks said in the 2004-2006 biennial budget, the Department of Military Affairs had been appropriated a deferred maintenance pool from which they could finance a number of projects. He said this project exceeds \$400,000, the threshold for reporting a capital project to the Committee. This project did not require any Committee action.

Representative Denham then introduced Ms. Nancy Brownlee, the new Director for the Division of Real Properties. Ms. Brownlee first presented a lease renewal report

for the Environmental and Public Protection Cabinet (EPPC) in Franklin County. She said only the existing lessor submitted a best and final proposal, and the lease was renewed at an annual cost of \$288,693 (15% increase) for a term of five years.

Senator Seum asked who decides what is an acceptable offer to accept when a lessor requests a rent increase. Ms. Brownlee said the original lessor in this case has had this lease since 1998 at the same rate of \$8.05 SF. She said they asked him to consider lowering his rate because he was the only respondent, but because the rate of \$8.05 had been in effect since 1998, he declined to do so.

Senator Seum observed if one considered a 3 - 4% annual inflation cost, then 15% since 1998 would not be out-of-line.

Mr. Abbott also noted that a relatively large amount of space (over 31,000 SF) was sought in the EPPC lease. There are few buildings of this scale available in Frankfort, which is indicated by receiving only one response to the advertisement. Mr. Abbott added that there has been a significant issue relative to the amount of leased property the Commonwealth occupies in Franklin County. He said the Administration has been working hard to lessen the state's dependency on leased property. Mr. Abbott said the state office building should be renovated and online in September 2007, and they are expecting a significant reduction in the amount of leased property that will be occupied by the Commonwealth in Franklin County. He said hopefully this will position the state in a favorable market condition relative to supply and demand.

Senator Buford made a motion to approve the lease renewal report for EPPC. The motion was seconded by Representative Marcotte and passed by unanimous roll call vote.

Ms. Brownlee next presented an emergency lease for the Department of Corrections, Division of Probation and Parole, which had been located in Kenton County's Fiscal Court Building. She said the Department was having numerous issues with sewage drainage from the county jail, which was located above the Corrections office. After numerous unsuccessful attempts to rectify the problem with the lessor, the Finance Cabinet advertised to lease space. No responses were received. Due to the health issues associated with the sewage drainage, the Cabinet declared an emergency to allow Corrections to acquire new office space via an alternative method. Local realtors were contacted for possible properties and over 40 sites were identified, which were narrowed down to three. The new lease, located at 30 West Fourth Street in Newport, has an annual cost of \$139,545, which includes water and sewer, and a term of seven years. Representative Denham said no action is required for emergency leases.

Next, Ms. Sandy Williams, Financial Analyst, Kentucky Infrastructure Authority (KIA), reported four new KIA loan requests. The first loan Ms. Williams reported was a Fund A loan request for the City of Richmond in Madison County. The City is requesting

a \$2,152,200 Fund A loan for planning and design work associated with the construction of a new wastewater treatment plant.

Ms. Williams said the City of Mt. Vernon in Rockcastle County is requesting a \$945,000 Fund B loan. The proceeds of the loan will be used to repay a short-term interim loan with the Kentucky Rural Water Association. Ms. Williams said the funds were used to complete improvements to the raw water intake line.

Ms. Williams then reported a Fund F loan request for the Columbia/Adair County Water Commission. The Water Commission is requesting a \$4,520,000 Fund F loan. The funds will be used to assist in the construction of a new water treatment plant.

The last KIA loan request Ms. Williams reported was \$4,000,000 for the Hopkinsville Water Environment Authority in Christian County. The Water Authority is seeking a Fund F loan to build an auxiliary raw water transmission line on Lake Barkley.

Senator Seum asked if all sewer entities need KIA approval before acquiring new debt. He said he understood that the Metropolitan Sewer District in Louisville had \$2.6 billion in debt obligations. Ms. Williams said KIA only approves debt that is borrowed through KIA.

Senator Buford made a motion to approve the four KIA loan requests. The motion was seconded by Senator Tori and approved by unanimous roll call vote.

Ms. Williams said members' folders included a report from KIA reporting line-item Coal/Tobacco Development Grants approved in previous sessions of the General Assembly. Representative Denham said no further action was required on these projects.

The next report was provided by Terri Fugate, Deputy Executive Director, Office of Financial Management (OFM), who explained they work closely with KIA on bond projects. Ms. Fugate discussed a report regarding the status of unspent proceeds from bonds issued to fund water and sewer grants administered by KIA. There have been five bond issues associated with KIA grant programs sold from 2001 to the present. Each issue, authorized amount, and amount of unspent proceeds is as follows: KIA 2020 Water Service Account (\$50,000,000; \$8,379,014); Water and Sewer Resources Development Fund for Tobacco Counties (\$54,765,000; \$19,139,881); Water and Sewer Resources Development Fund for Coal-Producing Counties (\$54,765,000; \$19,377,287); Infrastructure for Economic Development Fund for Tobacco Counties (\$126,000,000; \$112,604,442); and Infrastructure for Economic Development Fund for Coal-Producing Counties (\$80,000,000; \$70,745,731). The total amount of bonds issued was \$365,530,000, and the unspent bond proceeds were \$230,246,355.

[As a condition of issuing tax-exempt debt, the IRS requires that bond proceeds are not used to acquire investments earning a higher yield than the yield the issue is obligated to pay on the bonds, a financial strategy termed "arbitrage".]

Ms. Fugate noted that the unspent proceeds for the 2020 Program has about 17% unspent proceeds and will be hitting its fifth year arbitrage date on December 20, 2006. At that time, an arbitrage calculation will be made. KIA will contract for this service. She added that the bonds authorized by the 2006 General Assembly totaling \$250,000,000 will not be sold until after January 1, 2007, pursuant to the budget bill.

Representative Denham said the federal government is expected to increase interest rates next week. He asked Ms. Fugate if an interest rate increase would have an effect upon any of the KIA programs and the money that was put into the budget this past year. Ms. Fugate said a very conservative template rate was used in the budget process. She said the long-term interest rate has not moved much, and the short-term rates are rising some, but both are below the interest rate calculated by the template.

Representative Denham asked Ms. Fugate what KIA's arbitrage earnings were over the last four or five years. Ms. Fugate said the average yield on the KIA 2020 Water Service Account for the last four years was 4.62%. She did not have that information with her for the Fund A and Fund F bonds.

Representative Denham asked what, if any, problems KIA encounters when issuing grants. Ms. Williams said the biggest hurdle KIA has to face when issuing grants is when a community receives grant dollars and there is not a project in the works or it is on a needs list but the total funding package has not been finalized. She said projects cannot begin until the total funding package is complete.

In response to a question from Senator Buford, Ms. Fugate said there are exceptions as to how arbitrage earnings from tax-exempt bond issues can be invested. She said depending on where the market is and what the investments are, the yield being earned could be higher than the yield the issuer was obligated to pay on the bonds. She said as the bonds reach their third, fourth, and fifth year, they have to watch and restrict the yield carefully.

Senator Buford asked what is the total dollar amount of bond funds invested in a higher yield than the bond itself. Ms. Fugate said that has not been happening in the last few years. She said after the third year, they have to yield restrict to the arbitrage level, and there is just the three year window where an agency can earn more than the yield.

Ms. Fugate said it will be interesting in December when the report is done for the 2020 Water Service Account, since the bond issue has been the longest outstanding, and it was the first significant bond pool.

Ms. Fugate said OFM submitted one new bond issue report to the Committee this month: Kentucky Asset/Liability Commission General Fund Tax and Revenue Anticipation Notes (TRANs), 2006 Series A, \$151,133,835. Proceeds from this bond issue will be used to finance Fiscal Year 2007 General Fund cash flow requirements in anticipation of taxes and revenues to be collected during the fiscal year and to pay the costs of issuance of the notes. She noted that the initial thought was to size the TRAN as has been done in past years in an amount of \$500,000,000, but after taking a hard look at budget projections, it was decided that \$150,000,000 would be more in-line with cashflow needs.

Mr. Hicks added that when the General Assembly enacted the 2006-2008 budget, the ending balance that was budgeted to carry over into next year was approximately \$550 million, to be spent down through the next two fiscal years. In addition, there are continuing appropriations, which when unexpended at the end of the year, will carry over. He said when you consider these, they are looking at a \$700 million budgeted ending balance for 2005-06.

Mr. Hicks said when OFM goes to the market for working capital, they are counting both the budgeted ending balance and the balance that is reserved for continuing appropriations. He said the larger the ending balance, the less money they will borrow for the TRAN. He said these are not new numbers, but they are the largest they have had in any fiscal year history.

Representative Denham asked what the General Fund Surplus balance is expected to be this year. Mr. Hicks said they are expecting a surplus this year, but they have not estimated how much they are exceeding the revenue side estimate. He said they expect the bulk of the surplus is expected to be the result of revenues in excess of estimates rather than spending less than what was budgeted.

Ms. Fugate said the TRAN will be sold tomorrow (June 21, 2006) with proceeds to be deposited July 3. Ratings will be the same as in the past, and the coupon is expected to be 4.5% with a yield up to 3.65%. OFM will enter into a swap and will bid this out to the three underwriters that ALCo has engaged: Citigroup, JP Morgan, and UBS.

Representative Denham asked if \$150 million will be a sufficient amount for the TRAN. Ms. Fugate said this was a hard issue to analyze, and they are being very conservative in their estimates.

In response to a question from Representative Marcotte, Mr. Hicks said it would be accurate to say that \$42 million from the surplus account will be available to address the Alternative Minimum Tax issue to be discussed in the upcoming special session.

Representative Denham said TRANs are to be reported to the Committee within 30 days of filing, and no further Committee action is required.

Ms. Fugate then reported University of Kentucky General Receipts Bonds, 2006 Series A, dated August 31, 2006. The proceeds from this bond issue, \$24,560,000, will be used to fund the construction of a Student Health Facility and to pay the costs of issuance.

Senator Buford made a motion to approve the new bond issue. The motion was seconded by Senator Tori and passed by unanimous roll call vote.

Ms. Fugate next reported an amendment to the previously approved ALCo Project Notes, 2005 General Fund Second Series debt issue. The Finance Cabinet is proposing to amend this trust indenture to allow for preliminary financing of three projects authorized in the 2006-08 budget: Commerce Cabinet Horse Park Commission - Construct New Indoor Arena, \$36,500,000; General Government Military Affairs - Acquire Land for Wendell H. Ford Regional Training Center, \$4,500,000; and Finance and Administration Cabinet - Louisville Arena, \$75,000,000.

Ms. Fugate said they will be amending the 2005 indenture for additional projects at a future Committee meeting. She said the budget restricted the financing of most projects to a later date.

Representative Denham asked when they plan to begin construction of the Horse Park Arena. Mr. Hicks said in the 2005 session, funds were appropriated for design of a new Horse Park arena. He said they plan to begin a modest amount of construction spending since the 2006-08 Appropriations Act does not provide for financing construction until after January 1, 2007. (The project will maintain an accounts receivable account until January 1, 2007 when proceeds of the notes will be made available to reimburse the project.)

Representative Denham said he had some concerns about the original design of the project, and they need to make sure the design will fit all the breeds of Kentucky and not just a particular breed or two. He said he has conveyed his concerns to John Nicholson, the Executive Director of the Horse Park, and he agreed to take this into consideration.

Representative Marcotte asked how many acres are involved in the expansion of the Wendell H. Ford Regional Training Center. Mr. Hicks said approximately 5,000 acres is involved in this project. The state plans to purchase the land they are already occupying and leasing from Peabody Coal Company.

Senator Buford made a motion to approve the three amendments. The motion was seconded by Senator Seum and passed by unanimous roll call vote.

Ms. Fugate presented nine new school bond issues with School Facilities Construction Commission (SFCC) debt service participation: Dawson Springs Independent (Hopkins Co.), Frankfort Independent (Franklin Co.), Harlan County, Harlan Independent (Harlan Co.), Hart County, Jefferson County, Laurel County, Perry County, and Rockcastle County.

Senator Buford made a motion to approve the nine school bond issues. The motion was seconded by Senator Tori and passed by unanimous roll call vote.

Ms. Osborne said there was one locally-funded school bond issue submitted to the Committee for review this month for Clinton County. She said all disclosure information has been filed, and no further action on the bond issue is required.

Representative Denham said the Committee's next meeting is scheduled for July 18, 2006 at 1 p.m. He said the Committee will not meet on its regular meeting date in August (August 15), since that date conflicts with the National Conference of State Legislatures. The Committee will instead meet August 22.

With there being no further business, Senator Buford made a motion to adjourn the meeting. The motion was seconded by Senator Tori and the meeting adjourned at 1:50 p.m.